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The CFA Franc Parity Change: an opportunity to restore growth and reduce poverty

1. Introduction

Since 1986 the 13 countries of the CFA Zone have faced a profound economic, financial, and social crisis.[1] A downward deflationary spiral of incomes, expenditures, and production has cut average real per capita income by 40%. This prolonged recession impoverished much of the population of the Zone and weakened already inadequate basic social services. The deflationary spiral also undermined the Zone's financial institutions and threatened its continued existence. The only other region to recently experience a comparable economic contraction is the former Soviet Union.

The recent crisis was the result of a massive overvaluation of the real exchange rate caused by an unfortunate combination of inappropriate domestic economic policies and major external shocks. The internal adjustment programs pursued by the CFA countries were inadequate to depreciate the real exchange rate and, in fact, contributed to the ongoing downward economic spiral. A major policy change was called for.

In early January of this year, the Heads of State of the CFA countries met in Dakar to discuss measures for ending the economic crisis. On January 11, they decided to change the parity of the CFA franc from 50 CFA francs to 100 CFA francs per French franc and to adopt complementary economic reforms to restore growth. This was a historic decision. It changed a parity which had been fixed for 45 years and had been a central feature of the economic landscape in Africa for two generations. More importantly, the decision to devalue created a unique opportunity for the 13 CFA countries to restore growth, reduce poverty, and revi-

* *This paper reflects the views of the authors and should be used and cited accordingly. The findings, interpretations', and conclusions are the authors own. They should not be attributed to the World Bank, its Board of Directors, its management, or its member countries.*

1 *The term CFA Zone is used in this paper to refer to the 13 countries and two central banks of the Union Monetaire Ouest Africaine (UMOA) and the BEAC Zone (Banque des Etats d'Afrique Centrale). The Comoros, which has its own central bank, is the fourteenth African member country of the Franc Zone. Its currency was also devalued on January 12, 1994, from 50 Comoran francs per French franc to 75 Comoran francs per French franc.*

talize their regional institutions. It could have far reaching implications for the welfare of the 80 million people who live in the CFA Zone.

This paper discusses why the parity change was necessary and what additional economic reforms will be necessary to restore growth in the CFA countries. It summarizes recent economic analysis by the World Bank, much of which has not been previously published, concerning the need for a devaluation and comprehensive economic reforms in the CFA countries. The paper discusses, in order, the following topics:

(a) the dimensions of the recent economic, financial, and social crisis;
(b) the causes of the crisis and the resulting downward deflationary spiral;
(c) the desirability of preserving and strengthening the regional institutions of the CFA Zone;
(d) the failure of the internal adjustment strategy previously pursued and the need for a major policy change;
(e) the parity change and initial accompanying measures;
(f) the nature of the comprehensive economic reforms that must follow the parity change in order to restore growth, reduce poverty, and repair the regional financial system; and
(g) the political context in which reforms must be implemented.

The paper concludes by arguing that a new development strategy is needed by the CFA countries: a strategy that emphasizes a return to export-led growth, strengthened regional financial and trade policies, replacement of rigid rent-based economies by more flexible competitive ones, and high priority for human resource development and poverty reduction.

2. The Economic, Financial, and Social Crisis

2.1 The Economic Depression.

From 1970 to 1985, real income per capita of the CFA countries grew on average by about 2% per year despite variations caused by two petroleum price shocks, the primary commodity boom, and the start of the debt crisis. However, since the onset of the recent depression in 1986, real income per capita has fallen at a rate of 7% per year. As a result, average per capita income has been cut by a total of 40% - a decline in living standards similar in scale to that experienced by Europe and the US in the Great Depression of the 1930s.

Export expansion had been the engine of growth in 1970-85, as exports grew by 6% per year in real terms. Since 1986, however, falling commodity prices and an appreciating real exchange rate reduced the profitability of exporting and cut the real export growth rate by one half. Furthermore, as import prices rose in 1986-92 while export prices fell sharply, export earnings in current prices fell by one-third and the purchasing power of exports declined by 27%. The resulting reduction in incomes, imports, and production started a

downward deflationary spiral. Real investment, which grew at an average rate of 7% per year during the period of export-led growth from 1970-85, has fallen by an average of 7% per year since 1986. The current rate of investment, at 14% of the CFA's Zone's GDP, is barely sufficient to maintain the existing capital stock. It is adequate neither to support future growth of production and incomes nor to meet the basic needs of a population which is growing by 3% per year.

The prolonged recession has caused both the agricultural and industrial sectors to contract. Since 1985 agricultural production has declined by 0.5% per year, as the export and import-substituting sectors stagnated and land and labor were shifted towards subsistence production. The industrial sector growth rate dropped from +10% to -2% per year as the modern sector was hit hard by both the contraction of its markets caused by the domestic recession and by loss of market share to competing imports, which benefited from the overvalued real exchange rate (RER).

2.2 *The Financial Collapse*

The economic depression has had serious consequences for the public finances, aid donors' programs, and the financial systems in the CFA countries.

The export sector, which led the earlier economic expansion, had also been the source of growing fiscal revenues. Government revenues were heavily dependent on taxes on international trade and the surpluses of export marketing agencies. These were cut substantially by declining terms of trade, the appreciating real exchange rate, and the subsequent slowing of production. Consequently, government fiscal revenues fell from 21% of GDP in 1985-86 to 17% in 1990-91 despite some efforts to increase tax rates and improve tax administration.

In order to reduce the resulting fiscal deficits, governments have cut back public investment and non-salary development expenditures on health, education, agriculture, and maintenance of infrastructure. For political reasons, it has not been possible to reduce the civil service wage bill in line with the decline in fiscal revenues. Consequently, in most countries the lion's share of fiscal revenues is now consumed by the civil service wage bill. Substantial payment arrears have also been accumulated in a number of countries as the burden of the wage bill has been too great to finance from declining fiscal revenues.

Foreign assisted investment projects have been disrupted by pervasive shortages of counterpart funding. Both multilateral and bilateral aid programs have been increasingly diverted from development projects to budgetary support required to make up for shortfalls in government revenues. By 1993, the total external financing required to cover the ex ante budgetary gaps of the CFA countries had reached a level of 50 billion French Francs, an amount equal to more than 2 1/2 times total French aid to Africa. However, as donors became increasingly dissatisfied with the slow pace of reform and poor economic performance, external financial support evaporated.

The fiscal crisis caused serious liquidity problems for the banking system through the accumulation of government and public enterprise arrears. In addition,

the recession created financial difficulties for many private enterprises and led to a substantial increase in non-performing private sector loans. As economic conditions deteriorated and a devaluation appeared increasingly inevitable, capital flight accelerated, draining liquidity from the banking system. The repurchase of CFA bank notes from sources outside the Zone reached an annual rate of 9-10 billion French Francs in 1992-93. As a result, the Zone's financial system was being effectively undermined. The banking systems in a number of countries became insolvent and/or illiquid as a result of non-performing private sector loans, government and public enterprise arrears, and capital flight. Despite efforts to tighten bank supervision, revisions in interest rate policies, and restrictions on government interventions in bank lending decisions, the financial rules of the Zone were increasingly being called into question. Some governments were not able to abide by the Zone's legal restrictions on domestic borrowing, and currency convertibility had to be restricted in August 1993 to slow capital flight and protect the liquidity of the banking system.

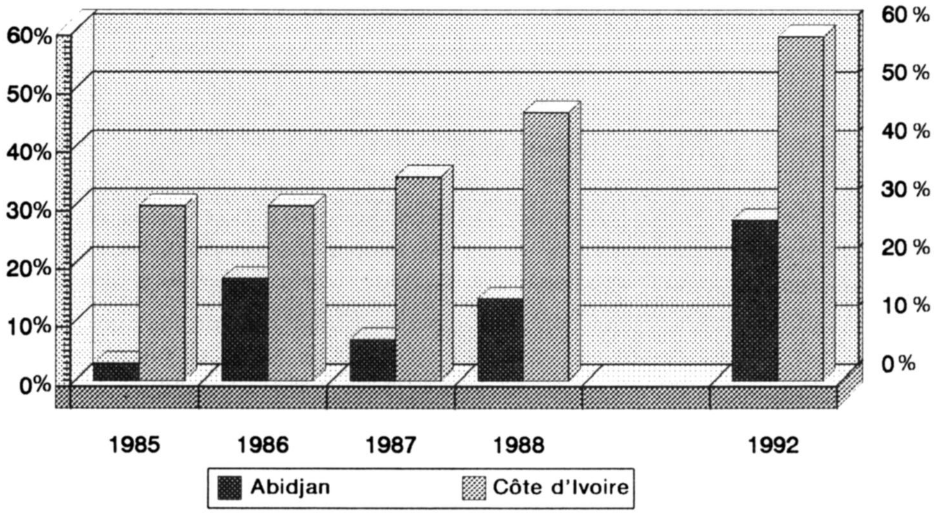
2.3 The Social Cost

Despite their staggering dimensions, the economic and financial crises have for a long time been ″silent crises″. Urban elites and articulate interest groups have, until recently, been able to protect the status quo for themselves as they controlled both the media and the political process in most countries. More recently, however, the ability of these privileged groups to control the political agenda has been reduced by social and civil unrest in some countries (e.g. Togo, Congo, Cameroon, and the Central African Republic) and the transition to more democratic forms of government in others (e.g. Benin).

While the living standards of a privileged minority have, until fairly recently, been relatively protected, the social cost of the crisis has been heavy for the less privileged majority. As noted above, average real per capita and household incomes in the CFA Zone have declined at an average rate of about 7% per year. Real per capita consumption, however, has declined more slowly, by about 4% per year, as saving rates were reduced to maintain consumption levels. In contrast, sub-Saharan Africa as a whole has enjoyed roughly stable real per capita consumption during this period.

In the Côte d'Ivoire, the one CFA country for which household survey data are available, the sharp decline in average income levels was accompanied by an equally sharp increase in the incidence of poverty, which doubled from 30% of the population in 1985 to around 60% of the population in 1992 (see Graph 1). Open unemployment doubled between 1985 and 1992. Low income (under) employment in subsistence agriculture and the urban informal sector expanded, while more productive income earning opportunities in export agriculture and the formal manufacturing sector contracted (Grootaert 1994).

Graph 1: Poverty Incidence in Côte d'Ivoire



Côte d'Ivoire, Cameroon, and Niger are among the CFA countries that have been the hardest hit by the crisis. A careful analysis financed by USAID showed that Cameroon and Niger probably also suffered substantial increases in poverty like those in Cote d''Ivoire (Dorosh and Sahn 1993). The increase in poverty has been of similar magnitude in other countries that have experienced comparable declines in real incomes (e.g. Congo). In those CFA countries where GDP has grown modestly (e.g. Burkina, Mali, and Benin),rural areas still suffered significantly from declining prices; but the overall impact of the crisis has been less severe, as per capita income levels have stagnated rather than declined sharply. Nevertheless, these were among the world's poorest countries at the start of the crisis and the stagnation of their incomes at very low levels is no more acceptable than the declining incomes in the other CFA countries (UNDP 1993).

Improving social conditions, with populations growing at about 3% per year, has proven impossible with the budget constraints faced by the CFA countries. In most of the countries of the Zone, total budgets for health and education have remained stable or declined in nominal terms. Most of the budget reductions have been made in the areas of non-salary operating costs, whereas staff salaries, subsidies to university students, and other forms of "social" subsidies to urban groups have been protected. New public investment in the social sectors has gradually stopped entirely. Private expenditures on education and health have been constrained by declining incomes and increasing poverty. School participation rates have stagnated or declined as a result.

The results of numerous studies of developing countries have shown that poverty can be significantly reduced only in expanding economies (see, for

example, World Bank 1990). Only a growing economy can generate employment, improve income earning opportunities for the poor, and provide the fiscal resources for expanding basic education and health services. Hence, a resumption of growth is critical for social as well as economic reasons.

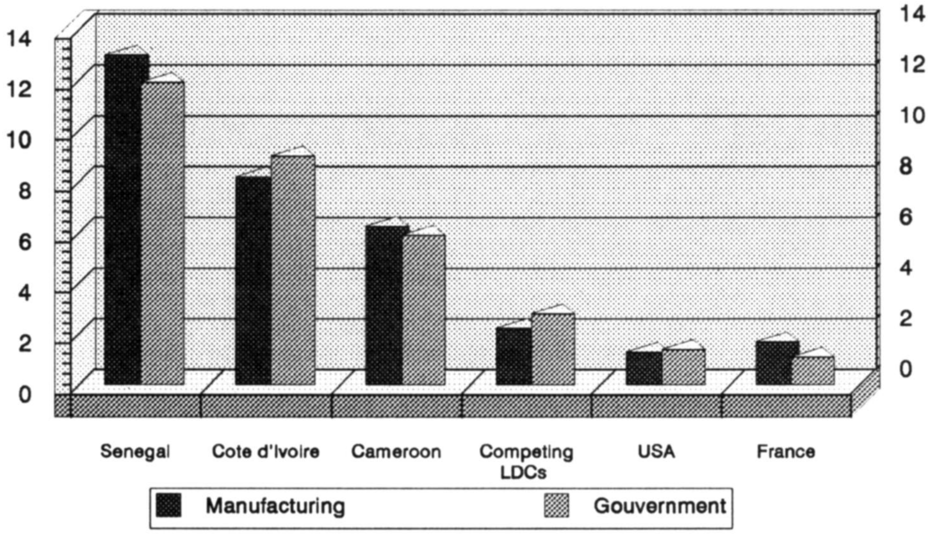
3. Causes of the Downward Spiral

The economic crisis in the CFA countries was caused by severe overvaluation of the real exchange rate. This overvaluation eroded the profitability of producing tradable goods (exportables and import substitutes) and aggravated both economic and financial imbalances and long-standing structural problems. Three factors are primarily responsible for the overvaluation of the RER: the legacy of inappropriate economic policies adopted during the earlier commodity booms; a substantial decline in the CFA Zone's terms of trade; and the appreciation of the French franc, to which the CFA franc is pegged, after the Plaza Accord in September 1985.

3.1 The Legacy of Inappropriate Economic Policies

During the commodity booms of the late 1970s and early 1980s, some of the larger CFA countries followed expansionary macroeconomic policies. Hence, even prior to the external shocks of 1985–86, a number of the CFA countries already had inflated and unsustainable cost structures. Wages in the formal sector in these countries then averaged 6 to 12 times per capita GDP, whereas wages in competing adjusting countries were 2 to 3 times per capita GDP (see Graph 2.). Thus, the cost structure was already inflated and important segments of the economy – particularly the manufacturing sector – were not competitive even in 1985.

Graph 2: Average Annual Labor Compensation, 1986 – 88, as a multiple of GNP per capita



Note: Competing LDCs is the average for 6 adjusting LDCs, i.e. Morocco, Ghana, Tunisia, Indonesia, Mauritius, and Malaysia.

Many of the CFA Zone's current fiscal and other financial imbalances also had their origins in the expansionary policies pursued in the late 1970s and early 1980s. Civil service wage bills grew strongly during this period and continued to increase even after the onset of the crisis (rising from 7.6% of nominal GDP in 1985–86 to 8.7% 1990–91). Much of the high level of public investment during the late 1970s and early 1980s was used to expand the public enterprise sector, large parts of which were uneconomic and accumulated substantial losses. When revenue increases slowed in the mid-1980s as export-led growth decelerated, many governments initially maintained expenditure levels through increased borrowing. Deficits increased accordingly.

3.2 The Collapse of The Terms of Trade

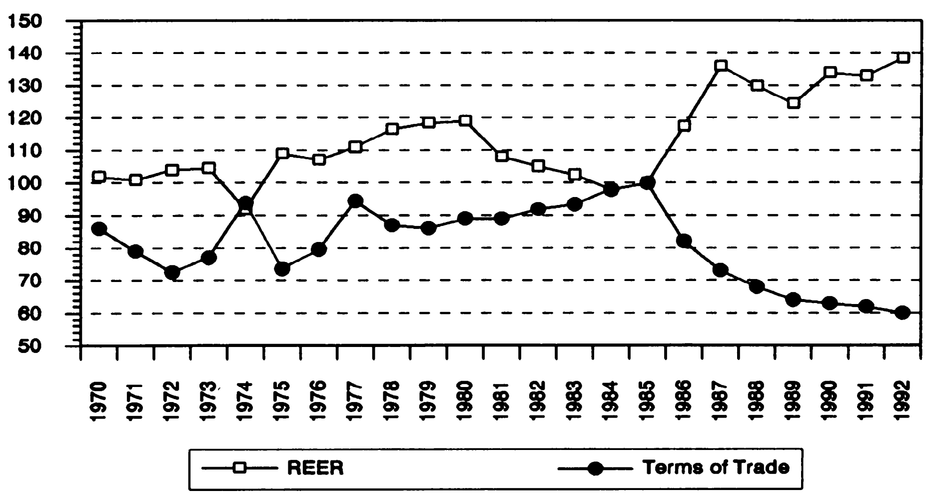
The overvaluation of the RER, which existed in 1985, was aggravated by the subsequent drop in the terms of trade. After rising slowly from the mid-70s to 1985, the CFA Zone's terms of trade dropped abruptly in the second half of the 1980s, declining by 40% between 1985 and 1992, as the prices of major export commodities (e.g., coffee, cocoa, and oil) fell sharply (see Graph 3). Declining

terms of trade reduced real income levels in the CFA Zone by 16% of GDP between 1985 and 1992, a very substantial loss of purchasing power in itself.

3.3 The Appreciation of the REER

In countries pursuing a flexible exchange rate policy, a substantial decline in the terms of trade would normally be compensated for by depreciating the real effective exchange rate (i.e., the trade weighted and inflation adjusted exchange rate) to restore the profitability of domestic export industries. However, exactly the opposite has happened in the CFA Zone: between 1985 and 1992 the Zone's REER appreciated by 39% (see Graph 3). This appreciation of the REER was the result of (a) the French franc's appreciating by 70% relative to the US dollar after the Plaza Accord in September 1985, and (b) competing Asian, Latin American, and African developing countries devaluing and depreciating their REERs in response to deterioration in their own terms of trade. The appreciation of the CFA Zone's REER further reduced the competitiveness of both its export and import-substituting industries.

Graph 3: CFA Zone: Real Effective Exchange Rate and Terms of Trade 1970 – 1992 (1985 = 100)



Note: An upwards movement of the REER is an appreciation.

As a result of a cost structure that, as noted above, was not competitive even in 1985 and the subsequent decline in the terms of trade and appreciation of the

REER, the CFA Franc became increasingly overvalued. Recent estimates using various analytical methodologies indicate that by 1993 the CFA Franc was overvalued in real terms by at least 50% on average in domestic currency terms, with the overvaluation ranging from 30% in some of the smaller economies to 60% in the larger ones.[2]

This substantial overvaluation of the RER has had a severe impact on the export and import substituting sectors. Traditional exports have lost market share as competing countries expanded production in response to their own favorable internal domestic price incentives while the profitability of the same export sectors declined in the CFA countries. Even export sectors where the CFA countries have a strong comparative advantage and excellent technical performance (e.g., rubber in Cote d' Ivoire and canned tuna in Senegal) have lost competitiveness as a result of the increasing overvaluation of the real exchange rate.

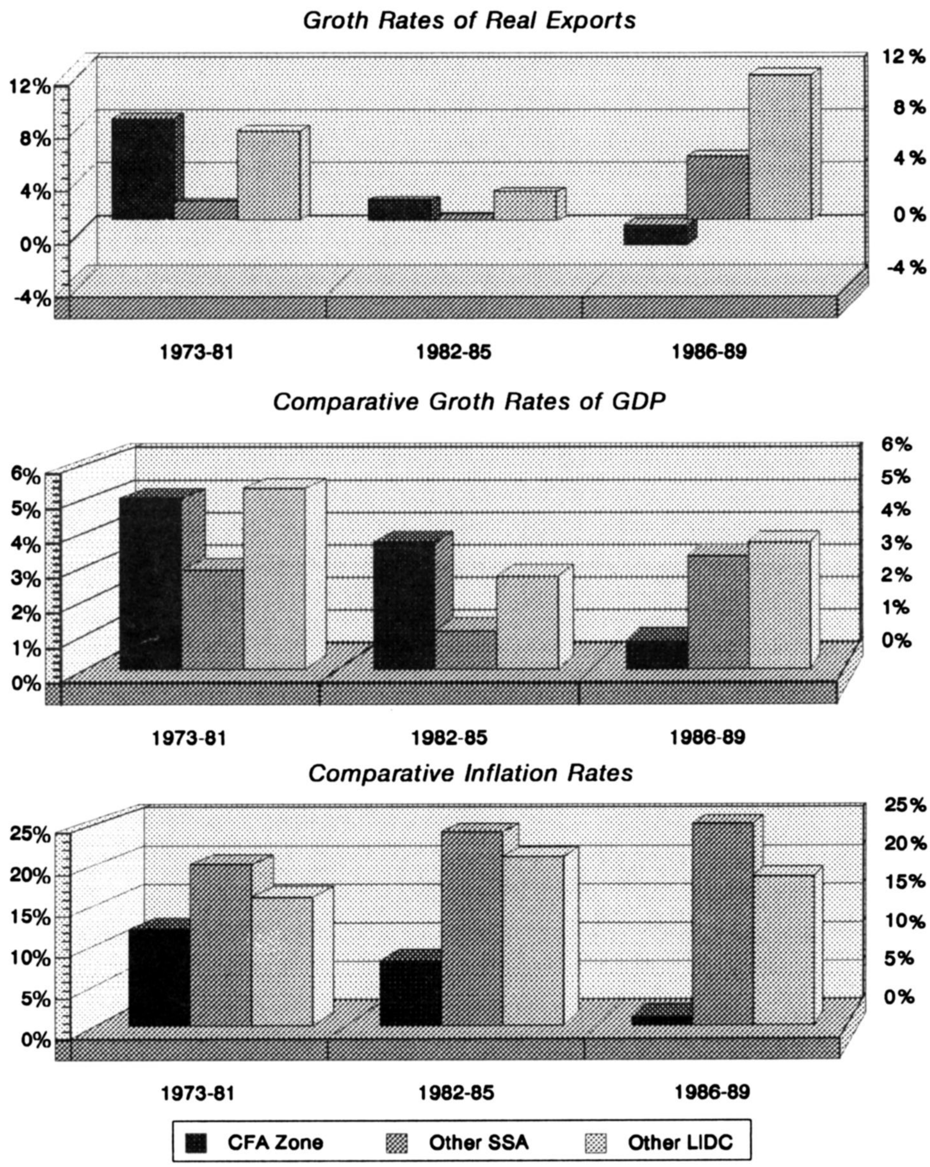
Import-substituting industries in the CFA countries have suffered equally. Until 1985-86, when the CFA Franc started to appreciate and the Naira was devalued, the CFA Zone exported numerous products to Nigeria. Since then, the trade flow has been reversed, with cheaper Nigerian imports flooding markets in the CFA countries. The textile industry has suffered particularly severely, and even agro-based industries have had difficulty in competing.

4. The Desirability of Preserving the Two Monetary Unions

Despite recent difficulties, the CFA Zone arrangements have conferred important advantages on the member countries. The two monetary unions have been among the most successful regional institutions in Africa. For a decade and one-half (1970 to 1985), they provided a reasonably stable macroeconomic environment which enabled the CFA economies to outperform the rest of Sub-Saharan Africa and achieve a performance level comparable to that of low income developing countries in other regions. During this period, export and GDP growth were higher and inflation was lower than elsewhere in Africa (see Graph 4). However, because a number of other African countries started to adjust in the second half of the '80s, while the CFA countries failed to do so, the Zone's relative economic performance has deteriorated markedly. Since 1986, median per capita GDP has fallen by nearly 2% per year in the CFA countries whereas it has risen by 1% per year in other adjusting SSA countries (World Bank 1994: pp. 144-145).

2 A common methodology for estimating exchange rate overvaluation is to analyze the differences between the official exchange rate and the parallel or black market rate and the volume of transactions taking place at each. Because of the guaranteed convertibility of the CFA franc, a significant parallel exchange market for it did not develop. Hence, in arriving at the overvaluation estimates cited, four alternative methodologies were used: (a) an analysis of movements in REER indices and comparative labor costs; (b) a computable general-equilibrium model; (c) an econometric analysis of determinants of the RER; and (d) a forward-looking balance of payments target/trade elasticities model.

Graph 4:CFA Zone: Annual Averages



Note: Other LIDC stands for Low Income Developing Countries, and SSA for Sub-Saharan Africa.

The principal institutional arrangements which made the earlier superior performance possible and which are worth preserving are:

(a) the independent regional central banks and their independent monetary policies;
(b) incentives for fiscal discipline through limitations on government borrowings;
(c) the incentive for monetary discipline represented by the "nominal anchor" to the French Franc;
(d) the full convertibility of the currency through the operations account with the French Treasury that is an important incentive for maintaining the Unions and accepting the required monetary/fiscal discipline; and
(e) the framework for further regional economic cooperation and integration through the reform of the Central African Customs Union (UDEAC) and the creation of the West African Economic Union (UEMOA).

The Zone's regulations governing fiscal deficits, public sector borrowing, and bank credit were violated or circumvented at various times making possible the policy errors discussed above. Nevertheless, until the crisis starting in 1986, the above arrangements helped to maintain low inflation and relatively open economic and trading arrangements which facilitated export-led growth. Hence, the challenge facing policy makers was to resolve the economic crises while preserving the institutional arrangements which gave the Zone growth with low inflation in the 1970-85 period, while correcting the problems that have emerged in recent years.

5. The Inadequacy of Internal Adjustment Alone

One policy option was to keep the parity unchanged and adjust to the external shocks solely through internal measures. This strategy was adopted throughout the Zone beginning in 1985.[3] Unfortunately, the "internal adjustment" strategy was a failure for the CFA countries as a group. Some countries (Niger, Chad, Togo, CAR, Congo, and Gabon) were unable to implement internal adjustment programs for economic or political reasons. Other programs (Côte d'Ivoire, Cameroon, and Senegal) failed – or had poor prospects for ultimate success – despite a reasonable reform effort for several years. Only three countries (Mali, Burkina, and Benin), where the competitiveness problem was the least severe, mana-

3 *The term "internal adjustment" is used in this paper in a broad sense to refer to a combination of deflationary macroeconomic policies designed to depreciate the RER and structural reforms to increase the efficiency and flexibility of resource allocation. That is, internal adjustment programs are defined as ones which exclude a devaluation. Some authors use the term internal adjustment in a narrower sense to refer only to the deflationary macroeconomic policies intended to depreciate the RER.*

ged to persist with reforms and achieve limited growth in per capita income. However, even for these three countries, the results of the adjustment effort were fragile and inadequate to sustain adequate long-term growth in per capita incomes.

The internal adjustment strategy failed in the CFA Zone for a number of interrelated reasons. **First**, the key macroeconomic obstacle to successful internal adjustment was that nominal wages and domestic prices of non-tradable goods were rigid downward in the formal sector because of monopoly/oligopoly arrangements and non-competitive labor markets. Therefore, a severe, prolonged recession was required to reduce domestic wages and prices enough to depreciate the RER to the extent required.

Second, the pursuit of deflationary fiscal policies to reduce deficits in a recessionary environment was self-defeating and reinforced the downward spiral. As noted above, the recession cut fiscal revenues and reduced the tax base. Raising tax rates in this deflationary environment to offset revenue losses and reduce fiscal deficits led to over taxation of the formal sector, a further loss of competitiveness, a shift of activity from the formal sector to the informal sector, and a worsening of the recession. Furthermore, for political reasons, it was difficult to substantially reduce the civil service wage bill. Thus, expenditure cuts were concentrated on investment and non-wage operations and maintenance expenditures. Public investment fell and expenditure on basic services (health and education) was inadequate. Moreover, the fiscal measures actually implemented were not adequate to prevent the accumulation of substantial internal arrears in government payments. These arrears reinforced financial system distress and aggravated the liquidity problems of private enterprises caused by the recession. In such a fiscal environment, neither the public nor the private sector could adjust successfully.

Third, it proved to be impossible to effectively implement second best trade policies when the exchange rate was substantially overvalued. Because of the recession, fiscal revenues were inadequate to actually pay envisaged export subsidies and finance the supporting services needed to develop export industries. High tariffs could not be enforced because of customs fraud and smuggling.

Fourth, the internal adjustment strategy had perverse effects on the financial system and private investment. The financial sector needed to be restructured to support the growth of the real economy. However, such a restructuring could not be successfully implemented while the on-going recession was increasing non-performing loans, public sector arrears continued to mount, and capital flight drained liquidity from the banking system. Similarly, private investment collapsed because of the recession and political uncertainty: profits fell sharply, financing dried up, and private investors awaited the end of the recession or a change in policies.

Fifth, the unfavorable economic, social, and political environment generated by the prolonged recession made it politically difficult to sustain the implementation of the reform program. During the recession, structural reforms in the CFA countries yielded benefits only slowly, and the process was perceived to be "all pain and no gain". Consequently, reform implementation has been difficult and has been reversed in a number of cases.

Never in modern economic history has a real depreciation of the magnitude required in the CFA Zone been achieved without a devaluation (Ghei and Kiguel 1993). In retrospect, it was unrealistic to have hoped to do so in the CFA countries. A fundamental change in policy was thus required.

6. The Parity Change and Initial Accompanying Measures

In order to extricate themselves from the recent crisis, the CFA countries needed to adopt comprehensive economic reforms to restore export-led growth, reduce poverty, and repair the Zone's financial system. However, as noted above, the reform process had come to a halt in most of the countries by the end of 1993. The parity change has provided an opportunity for relaunching it.

Since the devaluation in January, initial programs of accompanying measures have been put in place in 11 of the 13 countries and are currently under active discussion in the other two (Togo and Congo). These initial programs aim at halting the recession and achieving an average rate of GDP growth of 3% per year in 1994-96, led by a recovery in export growth to 6% per year and followed by a revival of investment later in the period. Since recent economic research has shown that much of the initial supply response to a depreciation of the RER often comes from the expansion of import-substituting industries in both the agricultural and industrial sectors, these industries are likely to benefit as much as the export sector from the devaluation (Pritchett 1992). The initial policy measures adopted are designed to achieve a depreciation of the RER, to initiate structural reforms, and to strengthen regional institutions. A return to more outward looking export-led growth and a dismantling of current rent based economic and political structures will need to be central objectives over the longer term.

6.1 Achieving a Real Depreciation

Despite all the controversy surrounding it, the devaluation is, in fact, the easy part of the reform process. The parity change in itself will achieve nothing if it is not accompanied by disciplined monetary, fiscal, and wage policies to insure that the nominal devaluation is not eroded by inflation and that the required depreciation of the RER is achieved. Real wages in the formal sector, which are way out of line with the productive capacity of the CFA economies, must necessarily decline to levels similar to those in other adjusting countries. There must also be a one-time increase in the prices of tradables - including, in particular, a quick, full passing through of increases in export prices to producers. But a general wage-price spiral has to be avoided by restraining nominal wage increases.

Hence, the recently adopted initial programs aim at holding the cumulative inflation in the Zone as a whole to no more than 50% over the next three years in order to achieve an average depreciation in the real exchange rate of about 40%. A primary instrument for achieving this objective is limiting public sector wage increases in 1994 to no more than 10–15%.

6.2 Making the Required Fiscal Adjustment

A fiscal adjustment is also critical to restructure budgets to support growth and poverty reduction while reducing deficits to help control inflation. The initial programs aim at reducing the average fiscal deficit from 11% of GDP in 1993 to 7% by 1996. Depreciation of the real exchange rate will tend automatically to improve the primary budget balance. Revenues should grow strongly as the tax base expands because of increases in prices of exports and imports and the growth in incomes, while the rising price level will cut the real burden of the nominal wage bill. To insure that the required structural changes in budgets take place, civil service wages will need to be restrained in order to provide scope for restoring public investment, for strengthened safety nets and other measures to protect vulnerable groups of the poor during the transitional period, for expanding basic social services, and for shrinking the fiscal deficit.

6.3 The Social Effects of Relative Price Changes

In the long term, virtually all segments of the population will gain from the resumption of growth in employment and incomes, just as all would surely lose from a continuation of past policies. The poor in particular stand to gain from a resumption of sustained growth because only in this context are meaningful reductions in widespread poverty likely to be possible. However, in the short term depreciation of the real exchange rate will lead to a significant redistribution of income, creating both winners and losers. For this reason, the devaluation has been both controversial and strongly resisted by some vested interests.

Among the initial winners will be rural areas and export industries, which will benefit substantially from the improvement in export prices and agriculture's terms of trade. The most important short-term losers will be in the urban formal sector, where real incomes must fall initially as part of the adjustment process. From this group come the vocal losers (students, unionized workers, civil servants), some of whom are complaining loudly about the changes, although most members of this group were not among the poor before the devaluation and will not be among the truly poor afterwards. Nevertheless, there are some groups, primarily in the urban informal sector, who are both truly poor and vulnerable to changes in prices of basic commodities and services in the short term. For this group of vulnerable poor, safety nets are required. Care will be needed to avoid confusion between political and social concerns.

Large nominal devaluations like that of the CFA franc can have a fairly strong impact on both relative prices and income distribution, with much of the effect

being felt immediately. In order to provide some time for urban consumers to adjust to the higher cost of imports and mitigate short term political opposition to the needed reforms, the initial programs have generally included temporary subsidies for a few selected basic consumer goods (e.g., rice, wheat/flour, edible oils, urban transport, medicine) in order to make the required restraint on formal sector wage increases politically acceptable. However, these subsidies will need to be phased out as quickly as possible as they retard the relative price and fiscal adjustments required to restore growth of incomes and employment. In selected cases, where continuing subsidies are justified to protect vulnerable groups, the initial general subsidies will need to be replaced quickly with narrowly targeted ones aimed at helping only the truly poor.

In addition to temporary subsidies for a few key items, the initial programs include other measures to protect the poor. The programs generally provide for protecting and then expanding, in real terms, non-salary expenditures on basic education, health, and infrastructure services. Actions to lower the cost and increase the availability of essential drugs and to expand social safety nets and labor intensive civil works programs are included in a number of countries.

6.4 Liberalizing Trade Policy and Strengthening Regional Institutions

Because of the increased protection that will be provided by the depreciation of the RER, and the need to restrain inflation, the parity change offered a good opportunity to accelerate trade reform. Under the initial adjustment programs, implementation of the UDEAC tariff reform, (which establishes four new tariff rates of 0–10–20–30%) and removal of non-tariff barriers (NTBs) have been accelerated in the Central African countries. Similar steps to remove NTBs and lower tariffs are being taken by the West African countries. A treaty converting the West African Monetary Union into a full economic union (UEMOA) was signed at the time of the parity change, and a framework for creating a Central African Economic and Monetary Community (CEMAC) from UDEAC and BEAC was approved in March 1994.

7. Towards a New Development Strategy

Depreciation of the RER by 50%, a quick and full pass through of export price increases to producers, and accompanying fiscal and real wage adjustments would, by themselves, contribute much to revitalizing the economies of the CFA countries. The parity change and implementation of the initial package of accompanying measures should be sufficient to halt the economic decline in most countries within 6 to 12 months. However, a strong sustained supply response can only be achieved if the initial measures are followed by other structural reforms.

A fundamentally new development strategy will be required to take advantage of the opportunity for restoring growth and reducing poverty that the devaluation has created. The following paragraphs briefly discuss four central elements of such an alternative strategy: i.e., a return to export-led growth, creation of competitive and more flexible economies, strengthened regional financial and trade policies, and accelerated poverty reduction and human resources development.

7.1 A Return to Export-Led Growth

In small low income open economies, such as those of the CFA Zone, export-led growth is the only viable option for accelerated, sustained improvements in living standards, and reduction in poverty. Only export-led growth can make possible rapid replication of technical advances on a large scale in a few key subsectors and generate enough foreign exchange to finance imports of a wide range of sophisticated intermediate and capital goods. In fact, since imports generally need to grow at least as fast as GDP and exports need to provide the bulk of the increased foreign exchange required, the rate of export growth typically sets a ceiling on the rate of GDP growth attainable.

Exports have led the growth of economies in Africa, just as in other regions of the world. Exports led the growth of the CFA Zone before the current crisis: from 1970 to 1985 exports grew at 6% per year, while GDP grew more slowly at 4%. An export recovery is now leading other adjusting African economies out of the recession caused by the terms of trade shock and the debt crisis, with their exports growing at 5% and their GDP at 4% since 1987 (World Bank 1994). The critical importance of an aggressive export push, generated by a high rate of private investment, is a central lesson from the "East Asian Miracle" (World Bank 1994).

7.2 Creation of More Competitive and Flexible Economies

In a rapidly changing, increasingly competitive world economy, rigid rent-based economies are doomed to failure, i.e. to further marginalization from world markets and continued aid dependence. Sustained export-led growth is possible only in competitive, flexible private sector oriented economies which provide stable macroeconomic incentives, an appropriate legal and regulatory framework, and the public infrastructure required for a rapid expansion of private investment. Rapid adjustment to a changing world economy must become a primary objective of economic policy, rather than the postponement of adjustment until there is no other alternative as has been the case with the devaluation.

Unfortunately, in the past, much of the benefit of export expansion in the CFA countries was siphoned off by rent seeking, and politics too often replaced markets in allocating resources. The strengthened price incentives for producing tradable goods that a devaluation will permit should be used to reward productive activity rather than to create new rent seeking opportunities in the public and pri-

vate sectors. Private sector monopoly/oligopoly practices and restrictive labor arrangements need to be reformed; non-tariff barriers, export taxes, and other anti-export biases eliminated; tariffs lowered and made more uniform; and complementary reforms in domestic taxation introduced. Bloated public payrolls, inefficient loss making public enterprises, and other predatory government practices also need to be eliminated to reduce the degree of state intervention in the economy.

7.3 Strengthened Regional Financial and Trade Policies

Relatively disciplined monetary and financial arrangements and open trading systems served the CFA countries well prior to the current crisis. Many of these key policies are based on regional institutions, i.e., on the two monetary unions and their corresponding preferential trading areas. Improvements in macroeconomic coordination, fiscal discipline, and monetary and financial sector policies will require strengthening of the UMOA and the BEAC Zone to maintain macroeconomic stability and create a financial system to support private sector growth more effectively.

Although it may expand in the future, intraregional trade within both UDEAC and UEMOA is relatively small and is likely to remain so over the medium term. Nevertheless, a number of important trade policies are determined at the regional level. Advancing trade reform on a regional basis also permits individual governments to utilize the common reform agenda and peer pressure to deal with opposition from narrow vested interests. To expedite trade liberalization efforts and provide a stable trade policy framework for export-led growth and expansion of private investment, accelerated implementation of the UDEAC fiscal and trade reforms needs to be completed, and further trade reforms in West Africa need to be actively pursued in implementing the recently signed UEMOA treaty.

7.4 Accelerated Poverty Reduction and Human Resources Development

The recession of the last eight years has been a disaster for human resource development in the CFA countries. Restoration of growth will create an economic environment which can provide growing employment and income earning opportunities for the poor. Growing fiscal resources will also be available for financing expanding primary education, health, and other basic social services. Accelerated human resource development will need to be sustained to help create competitive and more flexible economies and support the growth and diversification of exports. But, public policy initiatives will be necessary to realize the possibilities for accelerated human resource development that macroeconomic reform will make possible. Otherwise, the opportunity will slip away. Human development is the ultimate objective. It should be at the heart of a new strategy to provide a better future for the people of the CFA Zone.

8. The Political Context

8.1 Uncertain Commitment to Reform

Adoption and successful implementation of comprehensive reform programs will require political commitment. Although the parity change has removed one major obstacle and created the opportunity for initiating successful reform programs, it will not per se increase the political will to reform. Lack of political commitment to reform has been a serious problem under internal adjustment. Only a few countries (e.g. Benin, Burkina, and Mali) had been able to sustain the reform process prior to the devaluation. The political situation in much of Central Africa has been particularly inauspicious for reforms recently. Hence, mobilizing the political will to make the needed changes will be a major challenge for the governments of the CFA countries. The reform process is likely to be further complicated politically by two additional factors: (a) its coincidence with the process of democratic transition and (b) the regional aspects of policy making inherent in the CFA Zone monetary and trade arrangements.

8.2 The Democratic Transition

History has placed the CFA countries in the same situation as the states of the former Soviet Union, i.e.: they need to make profound economic reforms at the same time that new democratic institutions are being created. The transition to more democratic forms of government may or may not ultimately facilitate the economic reform process – one has only to reflect on the contrasts between the economic and democratic reform processes in the former Soviet Union and China to see the range of alternative outcomes possible. But history has given the CFA countries simply no choice: the economic crisis has coincided with the democratic transition. If growth is to be accelerated and poverty reduced, fundamental economic reforms will be required.

8.3 The Regional Aspect of The Reform Process

The economic reform process in the CFA Zone could be more complicated than elsewhere in Africa because of its regional dimension. At the regional level, the parity change will be an important test of the true commitment of the CFA countries to the two monetary areas. The current arrangements were put in place at the time of independence and "Africanized" somewhat during the 1970s. However, they still have neo-colonial aspects and associations. The political situation also varies from country to country, with some being more interested in regional reforms than others and the prospects for regional cooperation being better in UEMOA than in the BEAC Zone. Hence, it is clear neither (a) that the current regimes are committed enough to regional financial and trade arrange-

ments to pursue needed regional reforms at the expense of short-term domestic political interest nor (b) that more democratic governments will not view the CFA Zone as part of a neo-colonial ancien regime that needs to be scrapped like the former Soviet Union.

Important reforms will be required in the two monetary zones (BCEAO and BEAC) and their related preferential trading areas (UEMOA and UDEAC). Some national reforms will also need to follow reasonably consistent approaches across countries both because of the countries' membership in the common monetary and trade areas and because of the tendency of political interests in some countries to insist on following the precedents established by others. This regional dimension of the reform process could make it more complicated than elsewhere in Africa. But, on the other hand, it opens the possibility for governments interested in doing so to accelerate reforms of common interest by establishing joint positions in face of resistance by vested interests.

9. Conclusion: A New Beginning?

In view of the uncertain commitment of the CFA countries to reform at both the national and regional levels, it is unclear at this point whether or not history will note that the devaluation marked a new beginning for the CFA Zone. The Chinese ideograph for crisis means both danger and opportunity. It is a good symbol for the devaluation. On the one hand, the parity change was an unavoidable step for ending the economic, financial, and social crisis and for relaunching stalled reform programs. On the other hand, the urban populations and a number of the governments were not politically prepared for the change, and political difficulties were inevitable. Although the parity change was essential for restarting growth and reducing poverty, it was only the first step on an arduous path toward comprehensive economic reform. If the potential benefits of the parity change are to be fully realized, it must be followed by a program of economic reforms to generate export-led growth; create more flexible, competitive private sector oriented economies; strengthen regional financial and trade policies; and accelerate poverty reduction and human resource development. If the devaluation is not followed by further reforms, a number of countries are likely to experience a countinuation of the economic, financital, and social crisis.

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Zusammenfassung

Seit 1986 haben die Staaten der CFA-Zone mit einer schweren wirtschaftlichen, finanziellen und sozialen Krise zu kämpfen. Das durchschnittliche Realeinkommen sank um 40 %, Armut breitete sich rapide aus und gleichzeitig wurde die grundlegende soziale Versorgung abgebaut; das regionale Finanzsystem war unterhöhlt. Die Ursachen dieser Krise waren die erhebliche Überbewertung des Wechselkurses nach langen Jahren der fehlerhaften Wirtschaftspolitik sowie mehrere größere Schocks von außen. Am 11. Januar 1994 entschieden sich die CFA-Länder zur Abwertung des CFA-Francs und zur Einführung von Wirtschaftsreformen, um ihre Länder wieder auf Wachstumskurs zu bringen.

Die vorliegende Arbeit untersucht die Ursachen, die eine Abwertung notwendig machten und widmet sich den Reformen, die nötig sind, um künftiges Wachstum zu sichern, die Armut einzudämmen und das regionale Finanzsystem zu stabilisieren. Die Autoren gehen davon aus, daß eine Neuorientierung im Bereich der Entwicklungsstrategie erforderlich ist, wollen die CFA-Länder in den Genuß der Vorteile ihres Wechselkurssystems gelangen. Dazu gehören vor allem die Rückkehr zu einem exportorientierten Wachstum, die Umstellung der Wirtschaft hin zu mehr Flexibilität und Wettbewerb, die Stärkung der Finanz- und der Handelspolitik sowie eine Priorität für die Entwicklung und Förderung menschlicher Ressourcen.

Résumé

Depuis 1986, les pays de la zone franc C.F.A. sont plongés dans une importante crise économique, financière et sociale. Le revenu réel moyen baissa de 40%, la pauvreté s'accrut, tandis que les services sociaux de base se détérioraient de manière significative et que le système financier de la région était miné. La crise était causée par une surévaluation substantielle du taux de change, résultat de politiques économiques inappropriées et de grands chocs extérieurs. Le 11 janvier 1994, les pays de la zone franc

prenaient la décision historique de dévaluer le franc C.F.A. et d'adopter en complément des réformes économiques en vue de relancer la croissance.

L'article analyse les raisons qui rendirent nécessaire la dévaluation, et étudie les réformes nécessaires pour relancer la croissance, réduire la pauvreté et restaurer le système financier de la région. Pour profiter des bénéfices de la nouvelle parité des changes, les pays de la zone franc doivent adopter une nouvelle stratégie de développement. Celle-ci comprendra le retour à une croissance basée sur l'exportation, la réorientation de l'économie vers plus de compétivité et de flexibilité, le renforcement des politiques commerciale et financière et le développement des ressources humaines.